Capital Gains Tax issues on seperation & divorce

This information was correct at the time of writing (March 2021) and is now out of date.

A marriage or civil partnership breakdown is always stressful however amicable it may be. To avoid unexpected tax charges, it is important that couples[I] consider carefully the Capital Gains Tax (CGT) implications of their financial settlement. There may be a dry tax charge (a tax charge where no physical cash proceeds are received) and it is essential that all parties are aware of their tax exposure ahead of finalising any agreement.

The general rule is that asset transfers whilst a couple are "living together" (or during the tax year in which separation occurs), take place on a "no gain, no loss" basis. This means no capital gain or loss will arise and no tax will be payable. Transfers of assets after the couple cease to live together (and after the tax year of separation) are deemed to take place at market value regardless of any consideration that passes. Market value transfers may give rise to CGT liabilities.

Determining if a couple are "living together" can be complex. For tax purposes a couple are treated as living together unless they are:

- separated by a Court Order or formal Deed of Separation, or
- they are in fact separated in such circumstances that the separation is likely to be permanent.

This means that a couple who are not physically living together in the same house may be treated as doing so if their marriage or civil partnership has not broken down.

For tax purposes it is important to establish when the disposal has taken place. This can be complex where a divorce or separation are involved. Normally, the date of the transfer or disposal is the date the actual transfer takes place. However, if the disposal is part of a divorce or separation agreement the transfer or disposal will be the date of the agreement unless the transfer takes place pursuant to a court order. Disposals pursuant to a court order are generally deemed to arise on the date of the court order. However, if the court order precedes the decree absolute the disposal date is the date of the decree absolute.

The Family Home

For most couples, their main asset is the family home. Generally disposing of the main home does not result in a CGT charge providing certain criteria are met and the disposal qualifies for Private Residence Relief (PRR). However, PRR may not cover all the gain when the disposal occurs following separation or divorce.

Key points to consider when reviewing if a CGT liability will arise on the family home include:

- Couples are only allowed one main home qualifying for PRR between them. If following the separation each party has their own home, the disposal of an interest in the marital home may not be covered in full by PRR and a CGT charge could arise.
- The timing of any transfer is important. PRR can be extended for up to 9 months after a property ceases to be occupied as a main residence.
- There are limited circumstances[II] where a property can continue to qualify for PRR after being vacated. The conditions are strict, and specialist advice should be sought based on the personal circumstances.
- Where couples use more than one property as a home, they may need to make a formal election to HMRC. The election will nominate one of their properties as their main home for the purposes of PRR. This may help to optimise relief. Care is needed as there are set time limits within which an election needs to be made.

Where there are insufficient assets to allow one party to buy out the other's interest in the matrimonial home, either a Mesher Order or deferred charge maybe used. Each has a unique treatment for tax purposes.

A Mesher Order allows one party to live in the house rent free and on the eventual sale (often when children reach a specified age) the proceeds are split in specified proportions. A Mesher Order creates a lifetime settlement. CGT charges need to be considered when:

- the Mesher Order is put in place, and
- when the Mesher Order terminates (i.e. on children reaching a specified age or on the sale of the house).

The actual CGT position will depend on the individual circumstances. Advice should be taken to ensure no unexpected tax charges arise.

A deferred charge allows one party to transfer their share in the home in return for a deferred charge on the sale proceeds. The charge will not be realisable until a specified date (often upon a child reaching a specified age). CGT can arise on the transfer of the share in the house in return for the deferred charge. Again, this will depend on the specific circumstances and advice should be taken.

Other Properties

Transfers of other property interests (other than the main residence) are likely to give rise to tax charges. Without the benefit of any PRR the liabilities can be significant if the properties have been held for long periods and their value has appreciated over the price paid.

Where there are several properties jointly owned by the couple it may be possible to "exchange their interests" in the properties. This will result in each party becoming the sole owner of a property. This type of arrangement will be case specific but if the right circumstances arise, it may be possible to defer or at least mitigate the level of the CGT liabilities.

Business assets

Business assets, such as shares in a family company, may give rise to CGT liabilities where they are transferred as part of the separation or divorce.

Unless the transfer takes place in the year of separation the transfer will take place at market value. This will mean a valuation of the business interest is required.

In some limited circumstances it may be possible to "holdover" any capital gain arising. This delays the CGT liability until such a time as the asset is sold. Alternatively, it may be possible to claim other specific tax reliefs on the disposal.

HMRC have recently changed their guidance on when a claim for holdover is available on a separation or divorce, effectively reducing the circumstances where a claim can be made.

If both parties wish to continue to retain their interest in a joint business, it is important to ensure they will both continue to qualify for CGT reliefs going forwards. For example, if one party decides to step away from an active involvement in the business, but to retain shares, they may cease to qualify for Business Asset Disposal Relief (giving a reduced rate of CGT on a disposal). It is important to seek advice before making any decisions.

Any transfer of a business interest will require a valuation and case specific tax advice.

Other assets

As well as property and business interests there may be other chargeable assets that could trigger a CGT liability. These could include stocks and shares or valuable art and antiques.

Overseas assets

Careful consideration is required if either party to the divorce is not UK domiciled. Funds may need to be brought to (remitted) to the UK as part of the divorce settlement. Unexpected remittances (either directly or indirectly) could give rise to significant unexpected tax charges. Care is also needed where funds are held in an offshore structure (company or trust). The tax rules surrounding individuals not domiciled in the UK are very complex and specific advice should always be taken.

Other tax considerations

This note focusses specifically on CGT however other taxes should also be considered where assets are being transferred to include Stamp Duty Land Tax, Inheritance Tax and Income Tax.

[I] Couple refers to a married couple or civil partners
[II] Section 225B (TCGA 1992)

PEM
Salisbury House
Station Road
Cambridge CB1 2LA

t. 01223 728222
e. pem@pem.co.uk

A member of Kreston International | A global network of independent accounting firms

Please note that this brochure is not intended to give specific technical advice and it should not be construed as doing so. It is designed merely to alert clients to some issues. It is not intended to give exhaustive coverage of the topics. Professional advice should always be sought before action is either taken or refrained from as a result of information contained herein. The firm's full name and a full list of Partners is available on our website.